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SUBJECT: SKEPTICISM HAILS BEGINNING OF KHALIFA BANK TRIAL

REF: ALGIERS 00100

Classified By: DCM Thomas F. Daughton; reasons 1.4 (b) and (d).

11. (C) Summary: The trial stemming from the collapse of the Khalifa Bank empire started January 8 without the key defendant, bank founder Abdelmoumen Khalifa, who remains in exile in London. Some of Algeria's most powerful ministers and other economic luminaries have been called as witnesses, but Algerians remain skeptical that the trial will incriminate those truly responsible and are frustrated about the seeming incompetence of Algerian regulators. Conspiracy theories abound, but most Algerians seem to believe that the bank's demise was politically motivated. Indicative of the GoA's sensitivity over the case has been the Algerian reluctance officially to demand Khalifa's extradition from the UK, according to the British Embassy in Algiers. End Summary.

"SCANDAL OF THE CENTURY"

12. (U) The Algerian media has regularly referred to the collapse of Khalifa Bank as the "scandal of the century." Within a few years of its establishment in 1999, the bank had 60 branches and provided services to Algerian consumers that they had never seen before -- like credit cards. Moreover, what started as a bank soon expanded into a multinational empire consisting of an airline, television stations, construction firms and telecom holdings. After billions of dollars went missing and thousands of ordinary Algerians lost their savings, President Bouteflika authorized the liquidation of the bank in 2003. After it folded, the Algerian government passed an August 2003 ordinance raising the capital requirements of banks and requiring state-run industries to do business exclusively with public sector banks. The government subsequently pulled the licenses of seven banks and financial establishments that did not meet government standards. In addition, the government established a financial intelligence unit and tightened its money-laundering and counter-terrorist financing legislation.

TRIAL BEGINS

13. (U) The trial of 104 conspirators for fraud, money laundering and corruption related to the collapse of the Khalifa Bank empire started January 8 in Blida, a town just south of the outskirts of Algiers. Absent was the most prominent of the defendants, bank founder and erstwhile pharmacist Abdelmoumen Khalifa, who remains in exile in

London and is being tried in absentia. While the other defendants in the trial are mainly mid-level functionaries from the defunct bank and various state-run industries, the witnesses called to testify made up a veritable Who's Who of the Algerian economic scene. Three current ministers, past and present heads of the Algerian central bank, and the leader of Algeria's largest trade union have all traveled to Blida in recent days to testify.

14. (U) Revelations from the trial thus far have been minor compared to the magnitude of the scandal. When Khalifa Bank came to its crashing demise, an estimated USD 3 billion had been embezzled. The disclosure during the trial that the nephew of Movement for a Society of Peace (MSP) head and Minister of State Soltani had been hired by Khalifa Airways in Paris, or that Minister of Employment and National Solidarity Abbas was granted a limitless Khalifa Bank credit card, pale in comparison. The Algerian press also reported that a firm employing a niece of President Bush had received money from Khalifa on two occasions in 2002 (reftel).

CONSPIRACY THEORIES ABOUND

15. (U) Many Algerians believe that the bank collapsed for strictly political reasons and that the Algerian government does not want Abdelmoumen Khalifa to return to Algeria lest he implicate politicians or high-ranking military officers. In an interview on Al-Jazeera from London January 31, Abdelmoumen Khalifa pointed the finger directly at President Bouteflika. "Frankly, the state has nothing to do with it," announced Khalifa. "It is with Bouteflika that I am having a

problem. He did everything." This sentiment was most clearly expressed by a former Algerian diplomat in London, Larbi Zitout, who told the BBC that Khalifa Bank had been a tool of high members of the Algerian military and intelligence services to launder money, finance militias, purchase weapons, and buy political loyalty. Zitout declared that "as long as the generals continue to be the real decision makers in Algeria, the 'trial' will not reach its end. What we will see is a sentencing of some ordinary people -- the small fish if you want -- those who steal one, two, or even 10 million dollars; those who smuggled something here and something there will be jailed for 10 or 15 years and some ministers who have been mentioned will be dismissed."

16. (C) In a January 31 conversation with us, Mohammed Ghernaout, a financial expert who spent most of his career at Algeria's central bank, agreed that the downfall of Khalifa was for strictly political reasons and that the trial currently underway would lead nowhere. Ghernaout is the author of "Financial Crises and Failures of Algerian Banks: From the Petroleum Shock of 1986 to the Liquidation of Khalifa and BCIA Banks." He conceded that Abdelmoumen Khalifa had made some improper business decisions, but claimed that his downfall was largely the result of a deal struck between the Algerian leadership and French intelligence to open up the Algerian market to French banks. He told us that Khalifa had simply gotten too big too fast. Ghernaout argued that the French wanted a piece of the action and capitalized on Abdelmoumen Khalifa's reputation as a reckless, jet-setting playboy to support their case that the bank needed to be brought down. (Note: Ghernaout's prophecy has largely come true. In the past few years, French banks Societe Generale and BNP Paribas have opened over 50 branches in Algeria and are considered among the top contenders for the pending privatization of Credit Populaire d'Algerie. End Note.)

17. (C) Just as critical to the fall of the Khalifa empire, Ghernaout asserted, were its media interests. At its zenith, Khalifa had TV stations broadcasting from London (in Arabic) and Paris (in French). It had plans to rival al-Jazeera and move into print media. The Algerian leadership, Ghernaout said, viewed this unfiltered satellite coverage as a significant threat. Many argue that Khalifa television's failure to endorse Bouteflika in the lead-up to his 2004

reelection was the final straw.

DISINGENUOUS CALLS FOR EXTRADITION

18. (C) The head of the political section at the British Embassy in Algiers told us in mid-January that the Algerians were disingenuous about their stated desire to have Khalifa extradited from the UK. He said that while they frequently criticized Britain in the press for not returning Khalifa, the Algerians had in fact never officially asked for his extradition. The GoA had not acted on a paper that the British Embassy had supplied containing the required technical language to request Khalifa's extradition. The British diplomat drew the conclusion that the Algerian government had more to fear from Khalifa's return than from popular discontent at his continued residency in Britain. While there was no guarantee that HMG would return Khalifa if asked, "blaming it on the British nicely suited Algerian purposes," he told us.

GOVERNMENT COMPETENCE QUESTIONED

19. (C) Mokrane Ait Larbi, a defense attorney with experience in financial crimes, told us in late January that the competence of Algerian financial regulators was just as much on trial as the defendants in Blida. Larbi argued that financial regulators should have raised a red flag when Khalifa deposits were earning 11 percent as all other banks' interest rates fluctuated between five and six percent. "John Doe might not have a clue," he stressed, "but I refuse to believe that a governor or a minister was not aware of the weaknesses or dysfunctionality of the whole bank." Algeria's most famous political cartoonist similarly skewered the government's competence in a drawing of Finance Minister Medelci testifying at the Khalifa trial. The drawing depicts Medelci asking for clemency on the grounds that he was too stupid to understand what was going on. The caption below explains that this goes without saying, since he is a minister.

COMMENT

10. (C) While everyone here seems to have his or her own conspiracy theory of who was behind the collapse of Khalifa Bank -- be it Bouteflika, the military, or French intelligence -- most seem to agree that the trial currently underway will not close the book on the case. Despite the high-profile list of witnesses, many Algerians are grumbling that the true powers involved in the Khalifa scandal have escaped scrutiny. Neither Ali Benflis nor Ahmed Ouyahia -- the two successive prime ministers as the scandal was unfolding -- has been called to testify. Lending credence to suspicion of some degree of high-level government involvement has been the scant coverage of the Khalifa trial in the Algerian state media in comparison to the private press. In the end, it seems likely that no senior government official will be held accountable. We also note that thanks to Khalifa, ordinary Algerians have become distrustful of placing their assets in private banks, thereby complicating efforts to encourage much needed banking reform.

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